

Report of the auditor-general to the Limpopo Provincial Legislature and Council of the Mopani District Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the Mopani District Municipality set out on pages ... to ...; which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets and cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), Division of Revenue Act of South Africa, 2015 (Act No 1. of 2015) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting

estimates made by management, as well as evaluating the overall presentation of the financial statements.

5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my adverse audit opinion.

Basis for adverse audit opinion

Property, plant and equipment

6. I identified a difference of R143 066 690 (2015: R145 959 794) between the amounts recorded as accumulated depreciation of R3 190 924 556 (2015: R3 020 229 974) and my recalculation. Consequently, property plant and equipment are understated by R143 066 690 (2015: R145 959 794). Additionally, there was a resultant impact on the surplus for the period and the accumulated surplus.
7. Included in property plant and equipment is work in progress, where a difference amounting to R89 429 194 was identified between the amount recorded and my recalculation. Consequently, property plant and equipment is overstated by R89 429 194.
8. I was unable to obtain sufficient appropriate audit evidence for certain transactions amounting to R230 701 496 included in work in progress. I was unable to confirm these amounts by alternative means. Consequently, I was unable to determine whether any adjustment to property plant and equipment of R4 707 900 300 (2015: R 4 612 690 075) disclosed in note 3 to the financial statements, was necessary.
9. I identified a number of movable and immovable assets belonging to the municipality that were not accounted for in the accounting records. In the absence of an adequate internal control system over the recording of infrastructure assets, I was not able to determine whether any adjustment to property plant and equipment of R4 707 900 300 (2015: R4 612 690 075) disclosed in note 3 to the financial statements, was necessary.
10. The municipality did not have a system of control over property, plant and equipment as assets amounting to R54 720 015 (2015: R54 769 969) that do not belong to the municipality, were recognised in the accounting records. Consequently, property plant and equipment was overstated by R54 720 015 (2015: R54 769 968). Additionally, there was a resultant impact on the accumulated surplus.
11. Included in the financial statements are assets amounting to R121 463 809 that could not be verified. I was not able to determine whether any further adjustments to property plant and equipment of R4 707 900 300 (2015: R4 612 690 075) disclosed in note 3 to the financial statements, was necessary.

Inventory

12. I was unable to obtain sufficient appropriate audit evidence that inventory (water and consumables) had been properly accounted for, as internal controls had not been established over the recording of these transactions in the accounting records. I was unable to confirm inventory (water and consumables) by alternative means. Consequently, I was unable to determine whether any adjustment to the inventory amount stated as R23 653 321(2015: R17 943 825) in note 6 to the financial statements, was necessary.

Receivable from non-exchange

13. I was unable to obtain sufficient appropriate audit evidence that receivables from non-exchange had been properly accounted for, as the municipality did not maintain an adequate system of internal controls over its record keeping. I was unable to confirm the receivables by alternative means. Consequently, I was unable to determine whether any adjustment to receivables amount stated as R158 452 962 (2015: R233 268 717) in note 7 to the financial statements, was necessary.

VAT receivable

14. The municipality did not account for VAT on taxable transactions in terms of the VAT Act. The total value of VAT that was not recognised in the financial statements amounts to R50 993 052. Consequently, the VAT receivable balance in the financial statements is understated by R50 993 052. Additionally, there was a resultant impact on the surplus for the period and on the accumulated surplus.
15. I was unable to obtain sufficient appropriate audit evidence that the municipality accounted for VAT output in terms of the act, as the municipality did not maintain an adequate system of internal control over cash collections from consumer debtors. Consequently, I was unable to determine whether any further adjustments to the VAT receivable balance stated as R146 774 293 (2015: R105 596 069) in note 8 to the financial statements, was necessary.

Prior period error

16. SA Standards of GRAP 3: *Accounting policies, change in accounting estimates and errors* requires material prior period errors to be corrected retrospectively by restating the comparative amounts for the periods in which the error occurred by disclosing the nature of the prior period error, the amount, and the financial line item affected. The municipality's disclosure in note 38 to the financial statements does not include all prior period error misstatements in terms of the GRAP 3.
17. I identified differences amounting to R102 263 708 between the recorded amount of R4 467 037 338 and my recalculations. Consequently, prior period error corrections are understated by R102 263 708.

Consumer debtors

18. I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figure for consumer debtors. As described in note 38 to the financial statements, the restatement was made to rectify a prior year misstatement, but the restatement could not be substantiated by supporting audit evidence. I was unable to confirm the restatement by alternative means. Consequently, I was unable to determine whether any adjustment to the consumer debtors stated as R370 250 526 in the financial statements was necessary.
19. The municipality did not assess consumer debtors for impairment individually for significant financial assets or collectively for insignificant financial assets in accordance with SA Standards of GRAP 104, *Financial instruments*. I was unable to determine the amount of impairment by alternative means as the municipality did not maintain adequate records. Consequently, I was unable to determine whether any adjustments to the provision for doubtful debt balance amounting to R359 950 308 (2015: R2 776 708) as disclosed in note 27 to the financial statements, was necessary.

Contingent liabilities

20. I identified contingent liabilities amounting to R57 385 000 that were not disclosed in the annual financial statements. Consequently, contingent liabilities as stated in note 36 to the annual financial statement are understated by R57 385 000.

Commitments

21. The municipality disclosed commitments amounting to R21 498 710 for contracts which were completed and/or terminated as at 30 June 2016. Consequently, commitments as stated in note 35 to the annual financial statement are overstated by R21 498 710.
22. I identified differences amounting to R216 880 836 between the recorded amount of R425 598 922 and my recalculation. Consequently, commitments as stated in note 35 to the annual financial statement are understated overstated by R216 880 836.

Related parties

23. I identified differences amounting to R24 538 915 between the amount recorded as R23 671 010 and my recalculation of related parties. The municipality could not provide explanations for these differences. Consequently, the recorded amount of R23 671 010 in the underlying records has been understated by R24 538 915.

Payables from exchange transactions

24. I identified differences amounting to R55 105 539 between the amount recorded of R1 238 491 738 and the amount as per the underlying records. Consequently, payables from exchange transactions are overstated by R55 105 539. Additionally, there was a resultant impact on the surplus for the period.

Post-employment benefits

25. I identified differences amounting to R8 340 940 between the recorded amount of R1 274 242 under note 24 to the annual financial statements and the underlying records. Consequently, post-employment benefits is understated by R8 340 940. Additionally, there was a resultant impact on the employee cost R294 452 487.

Government grants and subsidies

26. The municipality did not recognise monies received as the implementing agent for certain projects, in accordance with GRAP 109, *Accounting by principal and agents*. Amounts reimbursed by the principal were incorrectly recognised as revenue. Consequently, revenue was overstated by R34 148 607 (2015: R 15 587 416). Furthermore, the costs incurred amounting to R22 532 576 (2015: R13 564 075) for these projects were recognised as expenditure in the accounting records instead of a receivable from the principle. There was a resultant impact on the surplus for the period and on the accumulated surplus.
27. In terms of GRAP 23, *Revenue from non-exchange transactions*, conditional grants should be recognised as revenue once the conditions attached to the grants have been met. The municipality did not account for the Department of Water Affairs refurbishment conditional grants amounting to R23 200 000 as revenue after the conditions were met. Consequently, revenue was understated by R23 200 000. There was a resultant impact on the surplus for the period.

Expenditure

28. I was unable to obtain sufficient appropriate audit evidence that expenditure had been properly accounted for, as the municipality did not maintain adequate controls over its record keeping. I was unable to confirm expenditure by alternative means. Consequently, I was unable to determine whether any adjustment to expenditure stated at R751 403 439 to the financial statements was necessary.

Employee costs

29. I identified a difference amounting to R40 450 925 between the amount recorded of R294 452 487 and payroll reports. Consequently, employee costs is overstated by R40 450 925.
30. I was unable to obtain sufficient appropriate audit evidence that overtime payments had been properly accounted for, as the municipality did not maintain an adequate system of records management. I was unable to confirm employee cost by alternative means. Consequently, I was unable to determine whether any adjustment to employee cost at R294 452 487 to the financial statements was necessary.

Provision

31. The municipality did not provide for the environmental rehabilitation of a new land fill site, as required by GRAP 19, *Provisions, contingent liabilities and contingent assets*. I was not able to determine the extent of the understatement of provisions stated at R120 010 790 (2015: R104 794 378) as it was impracticable to do so. Additionally, there was a resultant impact on the property, plant and equipment.
32. I identified difference amounting to R7 917 519 between amount recorded of R120 010 790 and supporting schedules. Consequently, provisions are overstated by R7 917 519.

Distribution loss

33. With reference to paragraph 12 above, I was unable to recalculate the water losses as disclosed in note 46 to the annual financial statements. The municipality's records did not permit the application of alternative audit procedures. I was unable to confirm distribution loss by alternative means.

Cash flow statement

34. The SA Standards of GRAP 2, *Cash flow statements* requires that the municipality summarise its operating, investing and financing activities. The cash flow statement and the related notes are not fairly stated due to the material effects of the matters reported on in the preceding paragraphs of this report.

Statement of budget and actual comparison

35. The SA Standards of GRAP 24, *Presentation of budget information in financial statements* requires that the municipality present separately, by way of a disclosure note, an explanation of material differences between the budgets for which the entity is held publicly accountable and actual amounts. The municipality did not provide explanations for the material differences between budget and actual amounts as required by the standard.

Additional disclosure in terms of MFMA

36. Section 125(1)(b) of the MFMA requires certain compulsory disclosures to be made in the financial statements. The municipality's disclosure in note 50 to the financial statements does not include all the compulsory disclosure requirements as in terms of the MFMA.

Irregular expenditure

37. The municipality made payments in contravention of the supply chain management requirements, resulting in irregular expenditure of R 28 295 627 (2015: R 64 126 364). As the municipality did not implement and maintain an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective, I was unable to determine the full extent of the understatement by alternative means.

Consequently, I was unable to determine whether any further adjustments relating to irregular expenditure disclosed at R267 216 061 (2015: R238 920 434) disclosed in note 41 to the annual financial statements, was necessary.

Adverse opinion

38. In my opinion, because of the significance of the matters described in the basis for adverse opinion paragraphs, the financial statements do not present fairly the financial position of the Mopani District Municipality as at 30 June 2016 and its financial performance and cash flows for the year then ended, in accordance with SA standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

39. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unauthorised expenditure

40. As disclosed in note 39 to the financial statements, unauthorised expenditure to the amount of R 169 214 083 was incurred as a result of overspending of the vote.

Fruitless and wasteful expenditure

41. As disclosed in note 40 to the financial statements, fruitless and wasteful expenditure to the amount of R 165 834 771 was incurred due to interest on late payments.

Restatement of corresponding figures

42. As disclosed in note 38 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of an error discovered during 2016 in the financial statements of the municipality at, and for the year ended, 30 June 2015

Material underspending of the conditional grant

43. As disclosed in the note 13, the municipality has materially underspent the budget on Municipal Infrastructure Grant to the amount of R75 662 544

Financial sustainability

44. The statement of financial position indicates that the municipality's current liabilities exceeded its total current assets by R309 564 829 which indicates that there is a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern. It affects the municipality's ability to meet its short term obligations and thus negatively impacts service delivery.

Additional matters

45. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited supplementary schedules

46. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these
47. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited this schedule and, accordingly, I do not express an opinion thereon

Unaudited disclosure notes

48. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

Report on other legal and regulatory requirements

49. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives of selected objectives presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

50. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information of the following selected objectives presented in the annual performance report of the municipality for the year ended 30 June 2016:

- Objective 3: Develop and maintain infrastructure on pages x to x
- Objective 4: Provide clean and safe water on pages x to x

51. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
52. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
53. The material findings in respect of the selected objectives are as follows:

Develop and Maintain Infrastructure

Usefulness of reported performance information

Consistency of targets

54. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. Of the reported targets, 43% were not consistent with those in the approved integrated development plan.

Reliability of reported performance information

55. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. The reported achievements against planned targets of indicators were not reliable when compared to the source information.

Provide clean and safe water

Reliability of reported performance information

56. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. The reported achievements against planned targets of indicators were not reliable when compared to the source information.

Additional matters

57. I draw attention to the following matters:

Achievement of planned targets

58. Refer to the annual performance report on pages x to x; for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs x; x; x of this report.

Unaudited supplementary schedules

59. The supplementary information set out on pages x to x does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report on them.

Compliance with legislation

60. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Annual financial statements

61. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.

Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving an adverse audit opinion.

Expenditure management

62. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

63. Reasonable steps were not taken to prevent unauthorised, irregular, fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Revenue management

- 64. An adequate management, accounting and information system which accounts for revenue, debtors and receipts of revenue was not in place, as required by section 64(2)(e) of the MFMA.
- 65. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

Asset management

- 66. Capital assets were sold, transferred or permanently disposed of without the approval of the council, as required by section 14(2)(a) of the MFMA.
- 67. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Liability management

- 68. An effective system of internal control for liabilities was not in place, as required by section 63(2)(c) of the MFMA.

Procurement and contract management

- 69. I could not obtain sufficient appropriate audit evidence that all contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as tender documents were not submitted to auditors for verification.
- 70. I could not obtain sufficient appropriate audit evidence that goods and services of a transaction value above R500 000 were procured by inviting competitive bids as required by *Supply Chain Management Regulation* (SCM regulation) 19(a) and 36(1).
- 71. Contracts were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
- 72. Awards were made to providers who were in the service of other state institutions or whose directors/principal shareholders were in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44. Similar awards were identified in the previous year and no effective steps were taken to prevent or combat the abuse of the SCM process, as required by SCM regulation 38(1).
- 73. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e).
- 74. Contracts were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43.

Consequence management

75. The unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA and *Municipal Budget and Reporting regulations* 75(1).

Internal control

76. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for adverse of opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

77. Action plans were developed however; they were not fully implemented, reviewed and monitored during the course of the year, resulting in the recurrence of the findings from the prior year.
78. Management did not provide effective leadership based on a culture of honesty, ethical business practices and good governance, protecting and enhancing the interests of the municipality, hence a part of the Municipal Infrastructure Grant was redirected to implementing agents.
79. The accounting officer and management did not exercise adequate and sufficient oversight responsibilities over the enforcement and implementation of the SA Standards of GRAP in the preparation of the financial statements.

Financial and performance management

80. The municipality did not have a proper system of record management that provides for the maintenance of information that supports the financial statements and reported performance information.
81. Management did not provide the required supervision and review over daily and monthly recording and reconciliation of transactions and account balances to ensure that the municipality complies with applicable financial reporting and legislation.
82. Controls over daily and monthly processing and reconciling of transactions were not implemented
83. Compliance with laws and regulations was not reviewed and monitored.
84. There is no proper record keeping supporting the financial statements and the annual performance report, consequently requested information could not be submitted.

Governance

85. Those charged with governance did not regularly provide adequate oversight over the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations.

Auditor-General

Polokwane

30 November 2016



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence